# Updates from East Asia for Business Lawyers

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## The Legal Service Market in China

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### I. Current Status and Development of the Legal Service Market in China

#### A. Overview

The prohibition against engaging in professional legal practices in China during the span of the Cultural Revolution (1966–1976) began an era that saw the complete absence of law firms. It was only in 1979 that the Communist Party decided to reestablish the legal service market, and in 1986 the Ministry of Justice (MOJ) organized the first Chinese Bar Examination, thus instituting a lawyer qualification system. The results of such efforts, and many more, by the government to reopen and revitalize the legal service market in China in the last twenty-five years are exciting. According to the latest statistics, today there are approximately 10,000 domestic Chinese law firms, with 120,000 registered lawyers in China. Moreover, since 1979, when Coudert Brothers became the first foreign law firm to establish an office in the People's Republic of China, the number of foreign and Hong Kong law firm offices in China has grown to over 154.

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## B. Law Firms

### 1. *Domestic Law Firms*

Early in the development of China's legal service market, the majority of China's domestic law firms originally concentrated solely on litigation. As time passed, they extended their involvement to activities such as drafting or revising contracts, and when the Chinese property market began to boom, many turned their focus to real estate property transactions. In 1993, some now very successful law firms began to engage in the fields of foreign direct investment (FDI), securities, and major tender projects. These new ventures were undertaken in response to the government's campaign to "build a socialist market economy".[1]

Consequently, the domestic legal service market in China can be identified according to three tiers, based on their primary legal practice area:

1) Low-tier: domestic litigation-related matters;
2) Second-tier: small to mid-sized FDIs, corporate governance; and
3) High-tier: international finance, trans-border mergers and acquisitions (M&A) and overseas initial public offerings (IPO).

Most of China's 10,000 existing domestic law firms are in the lower tiers struggling for financial survival. The handful of higher-tier firms is generally concentrated in Beijing.

The rapid increase of the legal service market has not, however, sufficiently ameliorated China's great deficiency of lawyers, a situation among the worst of all major developing countries. The percentage of lawyers among the total population in China is only 0.008 percent, a paucity compared to the United States (0.32 percent) or the United Kingdom (0.15 percent).[2] In addition, the development of China's legal service market with respect to location is rather unbalanced. Most domestic law firms are located in Beijing, Shanghai, Guangzhou, and Shenzhen, and only 20 percent are established in western China.

### 2. *International Law Firms*

According to an official notice issued by the MOJ at the end of 2003, there are now approximately 115 representative offices of international law firms in China. Most of these are American firms; however, thirty-five Hong Kong law firms have established thirty-nine offices in China. Many of these offices were set up within the last ten years and are still at an early stage in developing their Chinese practice. They are typically staffed with about five to ten attorneys and are mainly engaged in FDI-related businesses and overseas IPOs.

## C. Future Development

### 1. *Mergers among Domestic Law Firms*

Domestic law firms will likely continue expanding through mergers with other local firms.

### 2. *More Referrals Between Domestic and International Law Firms*

Despite market competition, there are areas where domestic and international law firms can pool their resources and strengths to cooperate with each other. Domestic law firms

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1. Elmer G. Wiens, *Government Enterprise: The Nexus of Socialism and Capitalism* (1999), *available at* http://modena.intergate.ca/personal/patelmer/papers/governmententerprises.html (last visited July 21, 2004).

2. He Ming, *Opinions regarding the Localization of Foreign Law Firms in China* (on file with author).

are generally more familiar with the legal and social environment in China. Therefore, they possess advantages with respect to maintaining relationships with local clients and government departments. However, international law firms, especially those with a long history and abundant experience in international business, are in a better position to provide high quality legal services to foreign clients and local enterprises in cases pertaining to international finance, trans-border M&A, overseas IPOs, and international trade. International law firms also have competitive advantages in representing Chinese clients in international arbitrations and overseas litigation.

Currently, it is not uncommon for international law firms with a permanent presence in China to have referral arrangements with domestic firms. In fact, such referrals may result in a close and trusted partnership between the law firms, or, if permitted under Chinese law in the future, result in a joint venture.

3. *Comparative Advantages of International Law Firms*

International law firms have advantages in dealing with high-tier businesses in China. This is particularly so in the following sectors:

a. WTO-related Business: Anti-dumping Issues

- *Anti-dumping measures against Chinese companies.* Since 1996, five years prior to its ascension to the World Trade Organization (WTO), China has been the largest target of anti-dumping measures in the world with anti-dumping cases against Chinese enterprises accounting for nearly 15 percent of all anti-dumping cases worldwide. The Chinese government and an increasing number of Chinese companies have realized that the best way, if not the only way, for them to defend themselves against such measures is to hire competent lawyers to represent them before the foreign government that is imposing such measures. American law firms have apparent advantages in attracting such businesses, as the U.S. government has initiated most of the anti-dumping cases against Chinese parties.
- *Anti-dumping measures adopted by the Chinese government.* In recent years, the Chinese government has been adopting anti-dumping measures either as a retaliatory measure or as a means to restrict the flow of imports from foreign countries, especially those deemed harmful to the development of local enterprises. The Chinese Ministry of Commerce (MOFCOM) most often targets the chemical industry for anti-dumping measures or investigations. Foreign companies subject to anti-dumping investigations in China tend to use international law firms with representative offices in Beijing for their defense.

b. Securities: Overseas IPOs

- In recent years, this has been one of the most booming areas of the legal service market in China. The increasing number of large State-owned enterprises (SOE) that underwent IPOs in the early 1990s has likewise spawned an increasing number of private enterprises seeking overseas IPOs.
- Chinese law requires a foreign lawyers' involvement for all Chinese enterprises seeking overseas IPOs. Thus, it is evident that securities practice, particularly in overseas IPOs, is a very promising market for international lawyers.

c. International Trade

Pursuant to part IV 83(c) of the *Report of the Working Party on the Accession of China* (*Report*), China confirmed that during the three-year transition period after its accession to the WTO, it would progressively liberalize the scope and availability of the rights to trade for all foreign invested enterprises (FIE) and domestic enterprises. The revised Foreign Trade Law of China became effective on July 1, 2004. Although the revised Law is generally lacking in detailed rules such as procedural rules and guidelines, the existing restrictions on foreign trade may not be eradicated as quickly as hoped for. However, it is anticipated that China will improve its laws and will gradually lift restrictions on trading rights, while international trade will continue to develop at a remarkable pace. This will surely expand the relevant legal service markets in China.

d. Mergers and Acquisitions

On one hand, with the economic development of China more and more Chinese enterprises will choose mergers and acquisitions (M&A) as an efficient tool for expansion. On the other hand, with the promulgation of the Provisional Regulations on Foreign Investors Merging with or Acquiring Domestic Companies (Merger Regulation),[3] foreign investors are provided with an entire legal framework to conduct M&A in China. Among the top ten M&As in China in 2003, seven of them involved foreign companies. With an increasingly high number of M&A transactions to come, relevant legal services by international law firms will be in great demand.

e. Dispute Resolution

Unfortunately for the business community, more business transactions will result in more conflicts and disputes. With the booming commercial market in China, such disputes are inevitable. This illustrates another promising area of practice for international lawyers, dispute resolution. Accordingly, among all three means of dispute resolution—litigation, arbitration, and mediation—arbitration is receiving more and more popularity because it provides amicability, flexibility, and confidentiality to the parties. The China International Economic and Trade Arbitration Commission received 704 cases in 2003, an increase of 4 percent from the 2002.

## II. Recent Noteworthy Developments

### A. The Chinese Constitution now Protects Human Rights and Private Property

In March 2004, the 2nd Meeting of the 10th Session of the National People's Congress was held in Beijing. The Constitution was revised for the fourth time. Among all revisions, the most remarkable ones are:

1. For the first time, the Constitution clearly stipulates that "rightful properties" should be protected;
2. The Constitution now stipulates the protection of human rights as a principle; and
3. It is emphasized that land in rural areas and land use rights in urban areas should not be expropriated arbitrarily, and that the procedures fixed in law must be followed.

Please note that "rightful properties" were mentioned in the first draft as "private properties." According to an informal consultation with an official of the State Council, the current wording permits the Chinese Government to maintain control over private properties.

3. Promulgated on March 7, 2003, by MOFTEC, together with the State Administration of Taxation (SAT), the State Administration of Industry and Commerce (SAIC), the State Administration for Foreign Exchange (SAFE). Effective as of April 12, 2003.

## B. Mergers and Acquisitions Activities Lead to Antitrust Review

Since 1994, many people have expected to see a national body of antitrust law emerge in China. However, no such law has since been promulgated despite an effort to develop one. Alternatively, China launched a field-tester on March 7, 2003 by introducing an antitrust notification and review regime for foreign-related acquisitions (Antitrust Rules), appearing as articles 19–23 of the much-debated Provisional Regulations on Merger and Acquisition of Domestic Enterprises by Foreign Investors (M&A Regulations). Under such rules, if the statutory thresholds are triggered, foreign investors are required to report their proposed acquisitions of Chinese companies, either onshore or offshore, to the Chinese antitrust authorities (i.e., the Ministry of Commerce (MOFCOM) and State Administration of Industry and Commerce (SAIC) before the acquisition is consummated.[4] The antitrust authorities will then examine whether the transaction would substantially lessen competition in the relevant market or lead to a monopoly and decide whether to permit or prohibit the transaction.

As promulgated, the emerging Antitrust Rules are lacking in implementation details. For example, the Antitrust Rules fail to include a list of documents to be presented to the authorities. Also absent from the Antitrust Rules is the time limit allowed to report the transaction, the definition of some basic concepts such as "market share" and "same line of industry," an explanation of the legal consequences for non-performance of the reporting requirements, and numerous other details.

The initial purpose of the Antitrust Rules was to echo the provisions of the anticipated antitrust law. However, under the current Antitrust Rules only foreign investors have the obligation to file an application for antitrust examination. Although the yet-to-be-promulgated antitrust law is expected to impose a similar obligation on domestic entities, in the absence of such a law the application of the Antitrust Rules breaches the principle of "national treatment."

## C. Amendments to the Foreign Trade Law Liberalize Foreign Trade

On April 6, 2004, the Standing Committee of the National People's Congress (Standing Committee) promulgated the revised Foreign Trade Law. It became effective on July 1, 2004.

4. The thresholds for notification of onshore acquisitions are: (1) either party to the transaction has an annual turnover of more than RMB 1.5 billion (USD $181 million) for the current year in the China market; (2) the foreign investor has acquired more than ten enterprises in the same line of industry in China within a single year; (3) either party to the transaction represented a twenty percent market share in China; or (4) either party to the transaction will account for a twenty-five percent market share in China after the acquisition. Moreover, upon the request of any domestic competitor or relevant government department or trade association, MOFCOM and SAIC may subject a transaction to the reporting requirement as long as they believe that the transaction involves a substantial market share, or has a significant impact on market competition, national well being, or national economic safety, even though none of the said thresholds have been met.

The thresholds for notification of offshore acquisitions are: (1) either party to the transaction owns assets with a value of RMB three billion (USD $362 million) or more in China; (2) either party to the transaction has an annual turnover of more than RMB 1.5 billion (USD $181 million) in the China market during the current year; (3) either party to the transaction and/or its affiliates have represented a twenty percent market share in China; (4) either party to the transaction and/or its affiliates will account for a twenty-five percent market share in China upon the completion of the transaction; or (5) upon the completion of the transaction, either party to the transaction will, directly or indirectly, own equity interests in fifteen or more FIEs in the same line of industry in China.

The revised Foreign Trade Law contains the following four notable amendments:

1. The release of restrictions on Foreign-Trade Rights;
2. The introduction of intellectual property rights protections;
3. The clarification of administrative supervision; and
4. The introduction of WTO trade remedy measures.

In article 5 of the Protocol on the Accession of the People's Republic of China (Protocol) and part IV of the *Report of the Working Party on the Accession of China* (Report), China committed to progressively liberalize the rights to trade within three years after its accession to the WTO. The revised Foreign Trade Law reflects China's efforts to comply with this commitment. Today, individuals are permitted to conduct foreign trade in China. This constitutes a key improvement upon the previous Foreign Trade Law. Foreign Investment Enterprises are granted national treatment, and Chinese and foreign parties have equal rights to engage in foreign trade. Furthermore, the revised Foreign Trade Law no longer divides foreign trade rights into "Own-Operation Import-Export Rights"[5] and "Rights to engage in foreign-trade circulation and operation business."[6] Therefore, after obtaining the proper business registration, both Chinese and foreign parties can determine what to import or export without limitations that are based on the type of business being operated, and subject only to limitations on particular goods such as gold and nuclear materials.

There is a separate chapter in the revised Foreign Trade Law on the protection of intellectual property rights in relation to foreign trade. The key provisions in this chapter echo the major principles of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs Agreement). Prohibition of the importation of pirated goods, provisions on the abuse of intellectual property rights by the rights holders, and the reciprocal protection of intellectual rights constitute the themes of this chapter. Likewise, as with the numerous other provisions in the revised law, these principles are generally lacking detailed procedural guidelines, and further clarifications are needed for efficient administration.

Another significant revision is the clarification of foreign trade investigations. Chapter VII of the revised Foreign Trade Law clarifies the scope of foreign trade investigations and provides brief procedures to be adopted by relevant foreign-trade authorities. The rules, however, are quite general and do not provide specific time frames. It is anticipated that further administrative regulations concerning the detailed rules for implementing such provisions will be promulgated soon.

Article VIII of the revised Foreign Trade Law permits several remedies to be adopted when the results of foreign trade investigations indicate that such remedies are necessary. Most of these remedies are actually rights quoted in WTO documents and include anti-dumping measures, counter-veiling measures, and security measures. This reflects China's progressive use of international treaties to protect its own interests.

In all, the revised Foreign Trade Law illuminates a remarkable advancement in China's fulfillment to its WTO commitments. However, there are still many promises to fulfill. The implementation of the revised law, and the abolishment of the existing restrictions on Foreign Trade will soon lead to further scrutiny.

5. *China's Accession to the WTO "Embracing the Opportunities, Meeting the Challenges,"* WTO Accession Monitor, *available at* http://www.tdctrade.com/wto/tid.htm (last visited July 21, 2004).

6. *China's Marketization Trend of Foreign Trade*, National Development Zones, *available at* http://www1.china.org.cn/english/2003chinamarket/79472.htm (last visited July 21, 2004).

## III. Foreign Lawyers in China

### A. General Restrictions

According to the Administrative Regulations on the Representative Institutions of Foreign Law Firms in China[7] and China's WTO commitment, foreign law firms in China are not permitted to conduct any "Chinese law business." Instead, they may only be involved in the following businesses:

1. Providing clients with consultancy services regarding the legislation of the country/region where the lawyers of the law firm are permitted to engage in professional legal work, and on international conventions and practices;
2. Handling, when entrusted by clients or Chinese law firms, legal affairs in the country/region where the lawyers of the law firm are permitted to engage in professional legal work;
3. Entrusting, on behalf of foreign clients, Chinese law firms to deal with the Chinese legal affairs;
4. Entering into contracts to maintain long-term entrustment relations with Chinese law firms for legal affairs;
5. Providing information on the impact of the Chinese legal environment; and
6. Directly instructing lawyers in the entrusted Chinese law firm, as agreed between both parties.

As of today, the most notable improvements, after China's WTO membership, with regard to the legal service sector are the elimination of the restriction on the total number of offices a foreign law firm can establish in China, the abolishment of the restriction that a foreign law firm may only establish one representative office in China, and the geographical locations of the representative institutions.

### B. Notable New Restrictions

Post-WTO China has introduced somewhat new restrictions on foreign law firms operating in China.

In 2002, the Ministry of Justice (MOJ) promulgated the Provisions of the Ministry of Justice on Implementation of Administrative Measures for Resident Representative Offices of Foreign Law Firms in China, imposing stricter limitations on the business scope of foreign law firms with a broad interpretation of "Chinese law business." Restrictions now cover the expression of advice or comments on legal issues governed by Chinese law in the capacity of a representative in arbitration proceedings. Representation in arbitration proceedings is nearly universally recognized as a type of non-legal service, and such a restriction is undoubtedly unfair and against China's WTO commitments. Moreover, this restriction will harm China's own arbitration commissions, as they will be the least popular arbitration venues if foreign law firms cannot represent their clients in China.

In light of this, the China International Economic and Trade Arbitration Commission (CIETAC) requested the MOJ to change the above restriction. The MOJ clarified its position in an official reply, stating that representative institutions of foreign law firms and

7. Promulgated by the State Council on December 22, 2001, and effective as of January 1, 2002.

their representatives can represent clients in China, but they should hire Chinese lawyers to provide legal opinions when Chinese law is applied. Since most arbitration cases are heard and decided under Chinese law, such clarification actually does little to lift the restraint on the capacity of foreign law firms and their employees to represent clients in arbitration cases in China.

## Recent Developments in Dispute Resolution in Asia: Beyond Globalization: Issues and Opportunities

Teresa Cheng*

With the increase in commercial activity in Asia, the process of dispute resolution is improving, and it now includes a review of the need for updating the various arbitration legislations of the different jurisdictions. Also, the courts in the various jurisdictions have developed the well-established principle that parties should be given the freedom to resolve their disputes in the manner in which they have chosen. This section will touch on some of the jurisdictions in the region where arbitration is the most common form of dispute resolution for international commercial disputes.

### I. Hong Kong Special Administrative Region

Since the 1991 amendments to the Hong Kong Arbitration Ordinance, there have been two systems for arbitration in Hong Kong—domestic arbitration and international arbitration. International arbitrations in Hong Kong are governed by the U.N.'s Commission on International Trade Law (UNCITRAL Model Law). The UNCITRAL Model Law has been well received in the Hong Kong international arbitration community and, indeed, in the arbitration community as a whole. As a result, the provisions and powers that are encapsulated in the UNCITRAL Model Law were introduced into the domestic regime by amendments to the Arbitration Ordinance made in June 1997. The amendments codify some basic and well-established duties and powers of the arbitral tribunal:

(1) To act fairly and impartially as between the parties, giving them a reasonable opportunity to present their case and to hear the case of their opponents; and
(2) To use procedures, which are appropriate to the particular case, avoiding unnecessary delay and expense so as to provide a fair means for resolving the dispute.

The arbitral tribunal in Hong Kong has broad powers, thereby limiting the need to have recourse to the courts during the course of arbitration. Indeed, the intervention of the courts in arbitration is very limited. For instance, the tribunal is given the power to order

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specific discovery, grant injunctions, order security for the claim and costs, and extend the time for bringing arbitration proceedings. Furthermore, the tribunal has the power to dismiss a claim where there has been undue delay in bringing it. Notwithstanding the fact that Hong Kong follows the adversarial model in its legal processes, the arbitral tribunal nonetheless has the power to act inquisitorially and investigate into the facts and law as it thinks appropriate. This power to act inquisitorially can be contracted out by the parties. With respect to costs, following the common law system and the well-established principles in litigation governing the provision of costs, a losing party will generally have to bear the costs of the winning party.

One sometimes hears the criticism that arbitration is hijacked by lawyers and hence replicates the litigation process and increases dispute resolution costs. Hong Kong has taken a positive step to resolve this issue by providing the arbitral tribunal with the power to limit the amount of recoverable costs in arbitration. Use of such power can be requested by either party by application to the tribunal. Some people take the view that it can also be invoked by the arbitral tribunal of its own volition. This power allows the tribunal to control costs and ensure a fair and speedy resolution of the dispute. A party can apply to the arbitral tribunal to limit the costs that the winner will be able to recover. If necessary, the application can be revised as the case progresses to increase the amount of recoverable costs. This power has a positive effect on parties who would otherwise exert financial pressure on the other side through the adoption of numerous and sometimes unnecessary interlocutory applications to the tribunal.

Article 10 of the UNCITRAL Model Law implies that there should be three arbitrators on the arbitration tribunal whenever the parties have not agreed on the number of arbitrators that will comprise the arbitral tribunal. In Hong Kong's experience, certain international arbitrations, which involve relatively straightforward issues and a relatively small claim, were not pursued due to the cost of a three-arbitrator tribunal. The need to adopt three arbitrators whenever the parties failed or forgot to set out the number of arbitrators in the arbitration agreement results in a number of claims being written off as bad debt. This is naturally unsatisfactory to the business community. Addressing that concern, since 1997 the Hong Kong Arbitration Ordinance has given the Hong Kong International Arbitration Centre (HKIAC) the power to decide whether, in the absence of an agreement between the parties, the tribunal shall be comprised of one or three arbitrators. The decision of the HKIAC will depend on considerations like the amount of the claim, the complexity of the issues, the desires of the parties, and any other relevant factors that are brought to the attention of the HKIAC. This power is frequently invoked and the feedback from the users is very positive. Small claims which were not pursued in the past because of the costs of a three-arbitrator tribunal are now satisfactorily resolved through the adoption of one arbitrator. Similarly, where disputes involve complex issues and large amounts of cash, the HKIAC has empanelled three arbitrators, thereby allowing the parties to benefit from the wisdom of three arbitrators as opposed to one.

It is not uncommon that the construction of an arbitral tribunal is the first hurdle to overcome with a reluctant or recalcitrant respondent. Previously, the claimant would have to make an application to the court and have a hearing before a judge before an arbitrator could be appointed. When international parties are involved, one can immediately see the inconvenience and the cost implications of such a procedure. As a result, legislation was written to allow the HKIAC to make the appointment. The application is made by way of a letter and the completion of a prescribed form, together with the payment of an application fee. The HKIAC will then process the application and choose the best-suited arbitrator for the particular dispute. The parties are then given a chance to comment on the arbitrator proposed, and if there is no genuine objection put forward, the HKIAC will proceed to appoint the arbitrator. This power was exercised a number of times and proved to be a very good process in constructing an arbitral tribunal.

Under article 16 of the UNCITRAL Model Law, the arbitral tribunal is given the power to rule on its own jurisdiction. This power was originally available only for international arbitrations conducted in Hong Kong, but is now provided to arbitral tribunals hearing domestic arbitrations in Hong Kong. As a matter of practice, this jurisdictional power has become a very useful tool in dealing with arguments as to whether the ruling of the arbitral tribunal is final. Today, when faced with a challenge to its jurisdiction, the arbitral tribunal will generally deal with such a challenge as a preliminary point and render an interim award on the issue. This gives the party the opportunity to take the matter to court for a final decision (with no further appeal) if the arbitral tribunal rules that it has jurisdiction.

The arbitral tribunal in Hong Kong also has the power to award simple or compound interest. Depending on the circumstances of the case, including trade practice and custom, the tribunal may decide to award compound interest as opposed to the simple interest awarded by the courts. This is welcomed in the commercial community, given that compound interest is often incurred as a result of breaches of contract or late/non-payment.

Turning next to the court's supervisory jurisdiction as well as supportive jurisdiction for arbitration, it is important to first note that the courts in Hong Kong have demonstrated a very firm stance of respecting the parties' wishes to arbitrate. This principle is of course enshrined in article 8 of the UNCITRAL Model Law as well as article III of the New York Convention, to which the People's Republic of China is a party. The court looks at whether there is prima facie a valid arbitration agreement and whether the dispute is a matter that is the subject of an arbitration agreement. When these conditions are satisfied, the court will always grant a stay of the court proceedings and refer the parties to arbitration unless the arbitration agreement is null and void, inoperative, or incapable of being performed.

Section 2GC of the Arbitration Ordinance gives the court the power to "intervene" in arbitrations. Special powers allow the court to order interim measures. Subsection six provides that:

> The court or a judge of the court may decline to make an order under this section in relation to a matter referred to in sub-section (1) on the ground that:
> (a) The matter is currently the subject of arbitration proceedings; and
> (b) The court or the judge considers it more appropriate for the matter to be dealt with by the relevant arbitral tribunal.

The powers vested in the court are very similar to those vested in the arbitral tribunal. It can be seen that while the court is given special powers to "intervene", this power is subject to the express provisions above, thereby limiting a party from going to the court whenever it wishes, and ensuring that the parties' agreement to arbitrate is honored.

In *The Lady Muriel*, the Court of Appeals in Hong Kong held that where there was a binding foreign arbitration agreement, the Hong Kong court should not make an inspection order unless it is satisfied "beyond a peradventure, that the [Applicant] . . . would suffer serious and irreparable damage if the order were not made." The Court of Appeals further held that where a party to an international commercial arbitration to be determined outside Hong Kong seeks an "interim measure of protection" from the Hong Kong court without obtaining the approval of the arbitrators, the Hong Kong court should refuse the application unless satisfied that justice necessitates the grant of the relief in order to prevent what may be serious and irreparable damage to the position of the applicant in the arbitration. Thus, while the Hong Kong court has inherent jurisdiction to grant interim protection in aid of a foreign arbitration, the court should be, and has been, "very cautious about granting such relief" when there is arbitration and should, therefore, allow the arbitral tribunal to deal with such matters.

The court's approach to foreign arbitration agreements outlined in *The Lady Muriel* is equally applicable where the arbitration agreement provides for arbitration in Hong Kong. This is true regardless of whether it is an international or domestic arbitration. In other words, as held by the Court of First Instance in Hong Kong:

> The legislature has provided for the intervention of the court, but in my view, this jurisdiction should be exercised sparingly, and only where there are special reasons to utilize it. A very special reason would be where the arbitral tribunal does not have the power to grant all the relief sought in a single application. Rather than apply to the tribunal for some of the relief and to the court for the other relief, it would obviously be more appropriate for the application to be made in its entirety to the court.[8]

An example of such special reasons includes an urgent ex parte application for an injunction, which may have to be enforced by serving a third party. The arbitral tribunal can, it is respectfully submitted, assist by writing a letter stating that this matter could only be satisfactorily dealt with in ex parte applications. This procedure is needed for the simple reason that the arbitrator has no power over a third party.

After an award has been published, the court's supervisory jurisdiction is further limited. In international arbitrations, the powers of the court are grounded in article 34 of the UNCITRAL Model Law. Under that article, the court can only set aside an award where there are procedural defaults. The court must be careful not to look into the merits of the dispute or the correctness of the findings of fact of the arbitral tribunal, but must concentrate on the procedural aspects of the arbitration to ensure due process.

For domestic arbitrations, the court has the power to grant leave to appeal on a point of law and to then decide on that point of law. This power is limited to points of law and does not allow rulings on findings of fact. The test by which leave to appeal can be obtained is well established in what has been called the "Nema" guidelines. In 1991, the Court of Appeals in Hong Kong has reiterated the Nema approach in *Lee Chang Yung Chemical Industry Corporation v. P.T. Dover Chemical Co.* Recently, this approach was reiterated again in the Court of Final Appeals in the case of *Swire Properties Ltd. v. Secretary for Justice.* Hence, where the question of law is one in which the general market and the commercial fraternity has an interest, and includes the interpretation of a contract in the context of events that are commonplace or likely to occur, and where the arbitrator is obviously wrong, the courts in Hong Kong will grant leave to appeal. This strikes a balance between the presumption of finality of arbitration and the prevention of a rogue arbitrator from using impermissible means of settling disputes. The balance has been well struck. It is strongly in favor of a presumption of finality for arbitration decisions and, in important cases, allows for leave to appeal on a point of law.

8. Leviathan Shipping v. Sky Sailing (on file with author).

No dispute resolution discussion is complete without looking at the enforcement of the result of the process. The People's Republic of China is a party to the New York Convention, and hence, a Hong Kong award can be enforced in any of the New York Convention signatory states.

As between Mainland China and Hong Kong, in June 1999 Hong Kong and the Mainland authorities entered into a Memorandum of Understanding entitled "Arrangement between Mainland and the Hong Kong Special Administrative Region on the Mutual Enforcement of Arbitration Award." The implementation of this Memorandum took place in February 2000 and became part of the Arbitration Ordinance. Since then, Mainland awards have been enforceable in Hong Kong. The Mainland has also implemented the arrangements outlined in the memorandum by way of the judicial direction published by the Supreme Peoples' Court in February 2000, allowing Hong Kong awards to be enforced in the Mainland. The mutual enforcement arrangements between Hong Kong and the Mainland are based on the provisions of the New York Convention. The approach, and the line of cases that deals with enforcement of the New York Convention awards are, therefore, equally applicable to cases dealing the with enforcement of Mainland awards in Hong Kong.

In June 2000, the enforcement provision in the Arbitration Ordinance, section 2GG, is further amended to provide that "[this section] applies to an award, order, and direction made or given whether in or outside Hong Kong."[9] This addition effectively enables awards made anywhere in the world to be enforced by way of summary procedures in Hong Kong. This has the benefit of allowing anyone who wishes to enforce a Hong Kong award in a non-New York Convention signatory state to rely on the international law principle of reciprocity.

In 1998, a committee on Hong Kong arbitration law was formed to review the needs for further development in the Arbitration Ordinance. The committee completed a report that suggested that amendments should be made to the Arbitration Ordinance that would allow the principles of the UNCITRAL Model Law to apply equally to both domestic and international arbitrations. The main recommendation was for a unitary system for arbitration law that would abolish the distinction between domestic and international arbitration.

The committee also recommended that parties should be required to "opt in" to an appeal on a point of law through leave of the court. This is important, given the suggestion for the unitary system and the desire, and indeed necessity, for the court to pronounce and develop principles of commercial law. There were different views as to whether, given the unitary system, leave to appeal should be abolished altogether. One can learn from the situation in England, where London is the leading international arbitration center. There, the courts always have the right to give leave to appeal a London award on a point of law. The ability to grant leave to appeal has helped London to become the leading international commercial arbitration center and is the reason why English law is the leading jurisprudence of many areas of commercial law.

Other suggestions related to the provision of security for costs. The committee recognized that security for costs is a concept not universally adopted. Therefore, it was suggested that the parties should be able to opt out of the security for costs provision. This also leads to certain controversial discussions, given that the fundamental rationale of security for

9. Legal Service Division Report on Arbitration, LC Paper No. LS144/99–00 (2000), *available at* http://www.legco.gov.hk/yr99-00/english/hc/papers/ls-144.pdf (June 2, 2000).

costs is to avoid the risk of the respondent not being able to recover costs after successfully defending a claim.

Accordingly, since 1990, reform efforts in Hong Kong were made that supplement the provisions of the UNCITRAL Model Law and make it more workable and user-friendly. These efforts aim to conform the UNCITRAL Model Law with international practice while adapting it to the Hong Kong legal system. The UNCITRAL Model Law, being a model, naturally will have to be modified to fit a particular legal system while still ensuring that the fundamental principles of providing a universally accepted, fair, and impartial dispute resolution process are maintained.

## II. Malaysia

The Malaysian Arbitration Act of 1952 incorporates the English Arbitration Act of 1950. It has some very outdated provisions such as a requirement to state a case for determination by the court on a point of law. This has caused a lot of delays in the completion of arbitrations in Malaysia. However, as a matter of practice arbitration in Malaysia has moved towards the kind found in international practice. There are provisions in the Arbitration Act of 1952 that limit the powers of the arbitral tribunal and allow more court intervention than what would be expected in the international arbitration community. As a result, Malaysia has been actively preparing a new Arbitration Act, which is more or less in its final form.

The Bar Council in Malaysia has proposed a draft Arbitration Act based on the UNCITRAL Model Law. The Malaysian Institute of Arbitrators has also proposed a draft Domestic Arbitration Act that is based on the English Arbitration Act of 1996. Both drafts are being reviewed by the Malaysian Attorney General's Chambers.

The Bar Council's proposal makes a distinction between domestic arbitration, where the right of recourse to the courts is preserved unless the parties choose otherwise and international arbitrations, where recourse to the courts is limited to the setting aside of arbitration awards as provided for in article 34 of the UNCITRAL Model Law. There is also limited intervention power by the local courts. The arbitration community expects that the reform is likely to take place sometime this year and will result in a more user-friendly arbitration system in Malaysia.

In the current Arbitration Act of 1952, section 34 provides that where an arbitration is conducted by the Regional Centre for Arbitration at Kuala Lumpur or where an arbitrator adopts the rules promulgated by it, the Malaysian court does not have any intervention power and the Malaysian Arbitration Act of 1952 does not apply. The original purpose of section 34 was to encourage non-Malaysian parties to use the Regional Centre for Arbitration at Kuala Lumpur by removing the Malaysian courts involvement. As events have turned out, given the protection prescribed by section 34, domestic parties also see the benefit of arbitrating under the Regional Centre for Arbitration at Kuala Lumpur or its rules. However, the disadvantage of precluding court intervention altogether is that the arbitrations conducted under the Regional Centre for Arbitration at Kuala Lumpur do not have the benefit of court assistance.

The general view in the Malaysian arbitration community is that such a separated system should no longer be preserved. Arbitrations conducted in Malaysia, whether by way of an ad hoc arbitration or under the Regional Centre for Arbitration at Kuala Lumpur, should be protected by the same Arbitration Act that limits court intervention. The arbitration community patiently awaits the finalization of the new arbitration statute, regardless of whether there is one statute for international arbitration and another statute for domestic arbitration, or just one uniform arbitration statute.

## III. Singapore

In Singapore, international and domestic arbitration regimes are governed by the International Arbitration Act, which incorporate both the UNCITRAL Model Law, which governs the conduct of international arbitration and the Arbitration Act, which governs the conduct of domestic arbitrations. Like Hong Kong, Singapore also allows the Singapore International Arbitration Centre (SIAC) to carry out certain appointment functions. Furthermore, there is a limited right to appeal points of law in domestic arbitrations.

In *John Holland v. Toyo Engineering*, the parties adopted the Rules of Arbitration of the International Chamber of Commerce (ICC Rules). The court held that the application of the International Arbitration Act and Model Law was thereby excluded as a result of the adoption of the ICC Rules. Shortly after the decision in *Holland*, the Singapore legislature passed an amendment that makes valid agreements to use other arbitration rules in international arbitrations if the parties "expressly agree" to opt out of the international Arbitration Act or the Model Law.

In another case, *Dermaja Properties v. Premium Properties*, the court considers the effect of the adoption of the UNCITRAL Rules vis-à-vis the International Arbitration Act or the Model Law. The court held that the UNCITRAL Rules, albeit adopted by the parties, were excluded because they are inconsistent with the International Arbitration Act and the Model Law. In October 2002, another amendment to the International Arbitration Act was passed that allows parties to adopt arbitration rules and have these rules apply to the extent that the adopted rules are "not inconsistent" with the International Arbitration Act or the UNCITRAL Model Law.

The SIAC has continually reviewed its procedures and guidelines governing arbitrator's fees. The SIAC has decided to provide a cap on arbitrator's fees as well as a reduction in the management fees that the SIAC would recover.

## IV. Thailand

Thailand passed new legislation that brings its arbitration system into line with the UNCITRAL Model Law. Arbitration Act B.E.2545 (2002) came into force on April 30, 2002. It provides for a unitary system for arbitrations within Thailand and makes modifications to the UNCITRAL Model Law. The Thai Arbitration Act does not, as yet, have any official English translation.

In line with the UNCITRAL Model law concept, the Arbitration Act limits court intervention to those instances that are expressly provided for in the Act. Further, the right of recourse to the courts to protest an arbitration award is based on article 34 of the Model Law, which allows for the setting aside of the award as a result of procedural defects. The Thai Arbitration Act allows parties to appeal a court order setting arbitration awards under three special circumstances:

(1) Where the order or judgment is contrary to the laws governing public order;
(2) Where the judge in charge of the case gave a dissenting opinion in the judgment; and
(3) Where the matter concerns an order imposing interim protective measures.

It is not clear how this provision works in practice given the relatively short time this act has been in place.

Except for measures regarding interim protection, the Thai Arbitration Act allows arbitrators to have the same powers as they would have under the UNCITRAL Model Law. Where interim protection is involved, the Thai Arbitration Act empowers the court to make such orders irrespective of what the parties have agreed. Under the Act, a party can make a request to the court for interim protection. The party requesting such interim measure for protection must proceed with the arbitration within thirty days or such other specified period.

One interesting feature in the Thai Arbitration Act is that where the parties have failed to designate the law to be applied to the dispute, then, contrary to article 28(2) of the UNCITRAL Model Law which empowers the tribunal to determine the law applicable in accordance with conflict of law rules, Thai law will apply. This, of course, has significant effects and indeed is a point to bear in mind when parties choose Thailand as the arbitration venue. Commercial contracts sometimes do not have an express choice of law clause. In that event, the default provision implies that Thai substantive law would be applicable. However, section 36 of the Thai Arbitration Act provides that where there is a conflict of laws, the arbitral tribunal shall apply the law it thinks applies as determined by conflict of laws jurisprudence.

Another unusual feature is that contrary to the UNCITRAL Model Law, and indeed contrary to the international practice of allowing the majority decision to prevail, the Thai Arbitration Act provides that failing a majority, the Chairman decides. It raises a question as to whether a two-party appointed arbitrators' decision could be treated as a majority that the Chairman can ignore. However, the intent of the Act must be otherwise, for it would result in a system in which of the arbitrator acts as an umpire as opposed to resulting in a system that has an arbitral tribunal with three arbitrators.

## V. Mediation

This is a dispute resolution process that is widely recognized and can be usefully adopted in certain disputes. In Hong Kong, where there is an arbitration agreement a mediated settlement can have the effect of an award, which is then easily enforceable as a judgment of the court.

Hong Kong also permits the arbitrator to act as the mediator if both parties agree. If the mediation is successful, then naturally the settlement agreement will have the effect of an award or, alternatively, it could be converted into a form of consent award. If it is unsuccessful, the arbitrator-turned-mediator will then have to revert back to the arbitration process. Doing so will incur the obligation to disclose confidential information given by the parties to the arbitrator-turned-mediator. This may cause concern to a lot of Western parties. But bearing in mind that such procedures are only adopted by agreement of the parties, the concern must not be overstated. Indeed, in the Mainland and in Taipei, experience is that this arb-med approach is often adopted. Arbitral tribunals have frequently turned into a mediation tribunals resulting in quicker and cheaper settlement of the disputes. The adoption of such procedures should not be subject to attack by non-parties because it is the parties who can decide which method to use and because it is up to them to decide whether the integrity and professionalism of the tribunal is such that they can agree to this course.

If the parties do not wish to use the arbitral tribunal as the mediation tribunal, they are perfectly entitled to, and sometimes do, carry out mediation concurrently with but behind the arbitration. The advantage of such an approach, as opposed to attempting mediation before arbitration, is that by the time arbitration is under way the issues are clearly identified through the pleadings provided in the arbitration. Therefore, the parties can focus on the dispute while bringing in other interests, which may not be before the arbitral tribunal.

As stated above, all these procedures are by the agreement of the parties, who must be given the freedom to choose the best procedures to be adopted. If they choose to ask the arbitral tribunal to resolve the dispute by mediation, it is up to the parties to trust and have confidence in the arbitral tribunal. This is not uncommon in Asian jurisdictions, given the cultural background. It is, of course, also up to the arbitral tribunal to decide whether it is comfortable with such procedures. Suffice it to note that in CIETAC, a large proportion of arbitrations are settled through this arb-med procedure.

In construction disputes, Hong Kong has modified the well-known principle of having a dispute review board by appointing one person, as opposed to a board, to monitor the differences between the parties so as to avoid disputes from arising while construction is ongoing. The advantage of appointing only one person is clearly that of cost-savings. In the Mainland, where the International Federation of Consulting Engineers (FIDIC) terms are often used for major projects, a dispute review board of a different form has been adopted. As the FIDIC terms continue to be adopted in the Mainland and in various parts of Asia, this dispute resolution (or perhaps dispute avoidance) measure should not be overlooked.

Adjudication is a process that has gained legislative support in England and Australia. In Asia, it has yet to attract legislative support. While it may provide an interim decision, such decision is only contractually binding. The parties are free to open up and review the decision of the adjudicator. Given that adjudication takes the shape and form of a short-form arbitration, it is sometimes said that adjudication is a dressed rehearsal of arbitration. Given the flexibility of arbitration, the need for such an interim and non-binding process is not clear.

The important matter to bear in mind is that the dispute should be resolved as soon as possible after it first arises. To allow a dispute to remain unresolved would result in the entrenchment of views as well as cause lengthy correspondence to be exchanged to protect one's position pending resolution. This point is particularly important when it relates to construction contracts, the execution of which may take years.

## VI. Conclusion

It is important to bear in mind that dispute resolution processes must be given freedom and should be viewed as a spectrum, with negotiation at one end and arbitration/litigation at the other. Choosing the right dispute resolution process for the particular dispute is the most important decision to make when a dispute arises. Because of the cultural background of Asia and the increased commercial activity in the region, the most popular dispute resolution processes tend to be arbitration or arb-med.

## Japan—Legal Reformation Still Moving Forward

Akihiro Wani*

### I. Modernization of Corporate Laws

In October 2003, the Judicial Council, Corporate Law Committee (Modernization Section) of the Ministry of Justice released the *Draft summary of essential points of modernization of corporate laws* (*Draft Summary*). The *Draft Summary* plans to consolidate company sections of the Commercial Code, the Limited Liability Company Law, and the Special Exemptions Law of the Commercial Code to create one new company law. Also, important amendments from a business point of view will be made.

The major proposals under the *Draft Summary* are as follows:

(1) For closely held companies whose shares cannot be transferred without the consent of the board of directors: Relaxation of the internal corporate structure such as not requiring a board of directors system, permitting a one director company, not requiring the appointment of statutory auditors, and no limitation on the scope of the resolutions of the shareholders meeting;
(2) Introduction of a U.S.-type limited liability company (LLC);
(3) Board resolutions can be made by written consent on the condition that no objection is filed by statutory auditors;
(4) Abolition of strict liability with regard to the liabilities of directors (adoption of new "negligence" approach);
(5) Introduction of "litigation committee" to the board of directors;
(6) Review of the minimum stated capital amount system;
(7) Abolition of the restrictions imposed on the capacity of a newly incorporated company; and
(8) Streamlining of corporate bond issuing procedures.

The *Draft Summary* does not intend to transform Japanese corporate law into Cayman-type legislation. Rather, it plans to create a "user-friendly" corporate law.

The Ministry of Justice is now reviewing the comments on the legislation made by various business sectors and plans to introduce the new corporate law in 2005. However, the details of the legislation are not yet clear.

### II. Amendments to Insolvency Laws

On February 13, 2004, the Ministry of Justice introduced to the Diet a series of bills amending the insolvency laws of Japan, in particular targeting the Bankruptcy Code for

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heavy amendment. This is primarily due to the changes in Japanese society and the huge increase in bankruptcy cases. Under the amendments, foreigners and foreign entities will be treated in the same way as Japanese or Japanese entities without any reciprocity requirements. Additionally, a court will be granted the power to suspend on-going foreclosure procedures or attachment procedures if necessary, an impossibility under the current law. Further, enforceability of set-off and close-out netting will be clearly confirmed. The amendments bar a trustee from nullifying a transaction entered into by a debtor and a third-party for fair value during the critical period just before the commencement of the bankruptcy proceeding. This amendment encourages a person or an entity in a difficult economic situation to make a good faith effort to sort out its problems without going to court.

In connection with the heavy amendments to the Bankruptcy Code, related proposed amendments were made to other insolvency laws such as the Civil Rehabilitation Law and the Corporate Reorganization Law. It is not known when these amendments will pass the Diet, but once passed they will become effective within one year of the date of promulgation.

## III. Amendments to Foreign Lawyers Law of Japan—Completion of the opening-of-doors to the Japanese bar

The Amendments to the Judiciary Law, which includes the amendments of the Foreign Lawyers Law (Amendments), passed the Diet on July 18, 2003. The amendments to the Foreign Lawyers Law should become effective by July 25, 2005, at the latest but are expected to become effective sometime earlier than that, possibly by the spring of 2005.

Under the current Foreign Lawyers Law, a special form of joint venture (*tokutei kyodo jigyo houritsu jimusho* or TKJ) is allowed, but the scope of business of a TKJ is strictly limited according to the qualification of Japanese and non-Japanese lawyers. (Note: To practice foreign law in Japan, a non-Japanese lawyer is required to be registered as a foreign-law business lawyer by the Ministry of Justice and the Japan Federation of Bar Associations.) For example, a Japanese lawyer may employ a non-Japanese lawyer but a non-Japanese lawyer cannot employ a Japanese lawyer. Thus, a TKJ works to create only "scratched-together" Japanese and non-Japanese law firms, not a unified firm. As a result, the creation of organized and seamless cross-border services is rather difficult. For example, if a party to the transaction is a non-Japanese party, but is a resident of Japan, the non-Japanese lawyer of a TKJ is not allowed to render legal advice even if he is qualified to practice the relevant non-Japanese law. Such TKJ restrictions have been heavily and widely criticized by clients.

The Amendments introduced the following changes:

(1) A non-Japanese lawyer may employ a Japanese lawyer, and a Japanese lawyer and a non-Japanese lawyer may share the profits originating from the foreign law joint-practice (*gaikoku-ho kyoudou jigyou* or GKJ). Thus, in effect the TKJ system will be abolished. This means the establishment of a partnership between Japanese and non-Japanese lawyers will become possible.

(2) A non-Japanese lawyer, based on the employment relationship, cannot instruct his associate who is not a Japanese lawyer to handle a case, which cannot be handled, by a non-Japanese lawyer under the Foreign Lawyers Law.

(3) A non-Japanese lawyer of a GKJ cannot participate inappropriately with the legal services provided by a Japanese lawyer who is a partner of the GKJ.

(4) The Japan Federation of Bar Associations should be notified of the employment of a Japanese lawyer by a non-Japanese lawyer and of the creation of a GKJ.

(5) By satisfying some conditions, non-Japanese lawyers of a GKJ may use the same firm's name as the Japanese lawyers of a GKJ can. However, the inclusion of "GKJ" to the firm's name is required.

Most Japanese domestic practitioners did not overtly oppose the Amendments when they were introduced, but some Japanese international practitioners resisted them strongly. However, those who oppose the Amendments cannot resist the market demands and the general trend of structural reformation of Japanese society for the new age. There is still a split view between the Ministry of Justice and the Japan Federation of Bar Associations as to whether or not the Amendments will allow the formation of a real partnership between Japanese lawyers in Japan and non-Japanese lawyers outside Japan. The text appears to allow the establishment of such a partnership, but there seems to be some resistance from the bar.

The Amendments will bring global competition among huge global law firms (so-called "Germanization") into Japan. Therefore, a huge shift in existing Japanese international law firms is expected. There will be winners and losers. Unfortunately, there will no longer be planned harmony among international practices in Tokyo. However, we should regard the Amendments as a key element in Japanese lawyers' efforts to provide legal services on a global basis and to work in a global organization.

## Korea: Recent Developments in the Areas of Corporate and Securities Law, Competition Law, and Labor Law

Sai Ree Yun*

### I. Corporate and Securities Law

#### A. Korean Securities Exchange Act

The Korea Securities Exchange Act (KSEA) was recently amended. The Act applies to the companies listed on the Korea Stock Exchange (KSE) or registered with the Korea Securities Dealers Association (KOSDA). The amendments were designed to increase the transparency of corporate accounting and governance, as well as provide incentives to prospective investors. The amendments will take effect on April 1, 2004, except as otherwise noted below.

Some of the more noteworthy changes to the KSEA are:

- Requiring a listed company's representative director (i.e., chief executive officer) or other appropriate officer to sign a certification that disclosure documents—including registration statements and annual, semiannual, and quarterly reports—are true and correct. This is intended to deter the making of untrue statements or omissions of material fact in disclosure documents.
- Imposing liability on de facto directors (as defined in the Korean Commercial Code) for damages arising out of untrue statements or omissions in disclosure documents.

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- Requiring at least one member of the audit committee to be an expert in accounting or finance, hoping to increase the level of expertise of audit committees.
- Protecting persons who have reported unfair securities trading activities to the Securities and Futures Commission, prohibiting discrimination or other forms of retaliation against such whistleblowers, and providing for the granting of monetary awards to whistleblowers.
- With certain exceptions, prohibiting a company from lending assets of economic value, such as money, securities, tangible assets, intangible property rights, etc., to major shareholders, directors (including the de facto directors), and auditors, from providing assets, such as real estate, movable property, securities, etc., as security on behalf of such parties, or from guaranteeing any obligation of any such party.
- Imposing criminal liability on certified public accountants, appraisers, or credit assessment professionals who, with knowledge of untrue statements or omissions of material fact in disclosure documents, nevertheless certify that the disclosure documents are true and correct. (The draft Enforcement Decree also would impose similar liability on other licensed professionals such as lawyers, patent attorneys, and certified public tax accountants.)
- Requiring the compensation packages of director and officers, including stock options, to be disclosed in the annual reports.
- Requiring that, in the case of large listed corporations (with total assets of KRW two trillion or more as of the end of the immediately preceding fiscal year), outside directors compose more than one half of the total number of directors. (This provision will come into effect on July 1, 2004.)
- Allowing quarterly dividends to be distributed to shareholders upon the resolution of the board of directors. (Currently, distribution of interim dividends is possible, but only once a year.)

## B. Securities Class Action Act

### 1. *Background*

Under the current legal scheme, if small investors suffer losses due to fraudulent accounting, auditing malpractice, false disclosures, manipulation of stock prices, insider trading, or other illegal activities relating to the stock market, it is difficult for the small investors to institute an action for damages. This is largely due to an absence of economies of scale. Moreover, there has been concern over possibility of multiple investors initiating lawsuits for the same cause of action arising out of the same set of events, resulting in an inefficient use of the court system. In response, in December 2003, Korea's National Assembly passed the Securities-Related Class Action Act (SCAA). The SCAA aims to provide a more effective means of relief for small investors and deter possible violations of the KSEA, thus enhancing the transparency of corporate governance. This controversial and long-delayed law will allow qualified shareholders to commence securities-related class actions, albeit only with prior approval from the courts and subject to various constraints.

For some corporations, the SCAA will begin to be applied on January 1, 2005. For corporate entities whose total assets—measured as of the end of the fiscal year immediately prior to January 1, 2005—amount to less than KRW 2 trillion, the SSCA will apply as of January 1, 2007 (except with respect to damages arising out of stock price manipulation).

2. *Noteworthy Features*

The SCAA is a procedural class-action law intended to make it easier for multiple plaintiffs to enforce their rights and seek redress. It is not a substantive law imposing new obligations on listed or registered companies. Some of the SCAA's major features are discussed below.

Securities class actions are limited to actions arising from a transaction involving securities issued by listed corporations. The causes of action for damages under the SCAA are further limited to the recovery of losses caused by: (1) untrue statements or a material omission of material facts in registration statements, business prospectuses, or annual, semiannual or quarterly reports; (2) insider trading; (3) the manipulation of stock prices, and (4) malpractice committed by an auditor.

Upon a court's receipt of a complaint and an application seeking permission from the court for the class action, the court will issue a public notice by publication in a daily newspaper of national circulation, as well as notify KSE or the KSDA, which will in turn post a public notice. The court will appoint one or more representative plaintiffs from among the members of the class, and if a representative plaintiff does not adequately represent the interests of the class, or there is some other material reason, the court, upon motion or of its own initiative, may prohibit the representative plaintiff from carrying out the action and may replace the representative plaintiff. A person who served as the representative plaintiff or a legal counsel in three or more securities related class actions within the past three years will be prohibited from serving as the representative plaintiff or legal counsel in a class action in progress.

A securities class action is permissible only if the following requirements are met: (1) the number of members in the harmed class is fifty persons or more; (2) the members of the class must collectively hold at least 1/10,000 of the total outstanding shares of the defendant corporation; (3) major questions of law or fact are common to all members of the class; and (4) the class action is an appropriate and efficient method for the members in the class to exercise their rights or protect their interests.

Withdrawals of class actions, settlement, waiver of claims, withdrawal of appeals, or waiver of the right to appeal is ineffective without the approval of the court. A court, upon motion or of its own initiative, may change the scope of the class. In order to protect the rights of class members, however, the court is required to give class members a chance to express their views before it makes such a decision. A class member can also request exclusion from the class by filing an exclusion report with the court.

The amount of damages will be determined by reference to the KSEA, which provides that the amount of damages shall be the difference between the purchase price and the sales price, if the shares were sold by the end of the hearing, or the market price as of the end of the hearing, if the shares are still maintained by the plaintiff. The SCAA, however, provides for the possibility of other methods of calculating the amount of damages. The final judgment will bind all members of the class, not only the representative plaintiffs.

When implementing a money judgment, the court may appoint a distribution administrator on its own initiative or upon motion of the representative plaintiffs. The distribution administrator shall, under the supervision of the court, distribute monies and other assets collected by enforcement of a writ of execution. Class members are required to report their claims to the distributor within the allotted period for reporting claims. If a class member fails to report his or her claim within this claim-reporting period, and if such failure is not due to a cause attributable to that class member, then that class member may report the claim within one month after the cessation of such cause.

### C. Act on External Auditors of Joint Stock Companies

Noteworthy amendments have been made to the Act on External Auditors of Joint Stock Companies (AEA). As in the recent amendments to the KSEA and implementation of the SCAA, the AEA amendments were motivated by a desire to increase the transparency of corporate accounting practices, thereby regaining the confidence of investors and the public. Effective April 1, 2004, the amended AEA will impose the following requirements on joint-stock companies with total assets of KRW seven billion or more:

- *Internal Accounting Management System:* A company must prepare internal accounting management regulations and establish a management/operational organization for gathering accounting information and disclosing it publicly. Accounting information must be prepared in accordance with the Internal Accounting Management System.
- *Internal Accounting Manager:* A company must designate one standing director as the person responsible for management and operation of the Internal Accounting Management System. Semiannually, the Internal Accounting Manager must report on the operation of Internal Accounting Management System to the board of directors and the auditor.
- *Outside Audit of Internal Accounting Management System:* The auditor must evaluate the Internal Accounting Management System each fiscal year and report the results of the evaluation to the board of directors. The evaluation report must be kept in the head office for at least five years.

Moreover, the amended AEA will:

- Provide protection to insider informants who report accounting improprieties and prohibit companies from retaliating against the informants;
- Except for foreign-invested companies who, because of their relationships with their foreign parent companies, consecutive audits by the same auditor are necessary, and companies listed on foreign securities exchanges and whose accounting transparency is assured to a certain extent, prohibit listed companies from being audited by the same auditor six fiscal years in succession;
- Authorize the Korean Institute of Certified Public Accountants to establish audit standards subject to prior approval by the Financial Supervisory Commission; and
- Require auditors to prepare audit reports with information about the scope of audits, audit opinions, and other information that would be useful to a potential investor for making a reasonable decision whether or not to invest.

### D. Seoul High Court Allows Double-Derivative Suit; Supreme Court May Not

The Seoul High Court's recent decision in *Eun Sub Jung v Pyong Sub Jung* 2002 NA 13746 (August 22, 2003) represents a significant landmark with respect to the issue of standing in shareholder derivative actions. The court held that the shareholders of a corporation have standing to file a double-derivative action on behalf of one of the corporation's subsidiaries against the subsidiary's directors, even where they possess no shares of the subsidiary. The first derivative action was filed in Korea in 1997. Therefore, the court's decision may be viewed as setting a precedent and indicating a move by the courts towards increased shareholder rights and director liability.

1. *Facts*

The plaintiff, an individual owning around 30 percent of the shares of Hwasungsa Co. Ltd, a Korean joint-stock company, filed a derivative suit seeking monetary damages against the defendants in their capacity as directors of Hwasungsa. The plaintiff alleged misconduct in connection with the initial public offering of shares of Sungdam Co Ltd., an 80 percent owned and controlled subsidiary of Hwasungsa, and the subsequent transaction for the sale of Sungdam shares to certain third parties for the purpose of settling Hwasungsa's inter-company debts. The plaintiff also filed a double-derivative suit against one of the defendants in her capacity as representative director of Sungdam, alleging misappropriation of funds in connection with the sale of certain real estate assets owned by Sungdam.

2. *Decision*

a. Issue of standing with respect to a double-derivative action

The most significant aspect of the court's decision is the issue of standing in connection with the double-derivative suit against one of the defendants in her capacity as representative director of Sungdam. The court held that the plaintiff had proper standing to file the double-derivative claim and ordered the defendant to pay damages to Sungdam. In its decision, the court considered the following two commonly raised arguments against allowing double-derivate actions:

*i. Contemporaneous ownership requirements.*

A frequently raised argument against double-derivative suits is that shareholders in such actions lack contemporaneous ownership, a legislative requirement that a shareholder own shares at certain times in order to bring the suit. Article 403 of the Commercial Code effectively provides that derivative suits may be brought only by shareholders owning at least 1 percent of the outstanding shares of a company against the company's director at the time of filing the action, while article 191–13 of the Securities Exchange Act changes this shareholding requirement to at least 0.01 percent of the outstanding shares to be continuously owned for the past six months at the time of filing with respect to listed or KOSDAQ (Korean Securities Dealers Automated Quotations) registered companies. These provisions do not require the shares to be held at the time of the cause of action. However, according to a strict reading of these provisions, a company shareholder who does not hold shares of a subsidiary company would be barred from filing a double derivative suit on behalf of such subsidiary against its directors.

*ii. Alternative remedies.*

Another commonly raised argument against double-derivative suits is that shareholders in a double-derivative action already have a remedy available in the form of a derivative action on behalf of the parent company against its directors. According to this reasoning, a shareholder must demand a remedy from both the subsidiary's and the parent's board of directors before filing a double-derivative suit. Once the parent's directors have refused to take action regarding the subsidiary at issue, a double-derivative action is unnecessary, because the shareholder has a remedy in the form of a single-derivative action against the parent's directors on behalf of the parent corporation for failing to take action to protect the parent's investment in the subsidiary. This falls under the principle that any harm to the subsidiary constitutes a direct harm to the parent.

The court ultimately rejected the foregoing arguments as inequitable and artificial. In the court's opinion, it is necessary to permit double-derivative actions in certain cases such as *Eun Sub Jung*, where both the parent company and the subsidiary are under the common control of the defendants. Otherwise, the defendants could shield themselves from liability by conducting business and any potential improprieties through the subsidiary. In addition, the alternate remedy of single-derivative suits is not feasible in some cases because it may be very difficult to appraise the indirect harm to the parent company caused by the direct harm to the subsidiary. Moreover, relying on single-derivative actions may result in multiple derivative suits filed by the respective shareholders in cases where multiple shareholders own shares in a single subsidiary corporation. By contrast, only one double-derivative suit would be necessary to provide a remedy for all the shareholders holding stock in the subsidiary.

The court also cited general policy reasons for its decision of allowing double-derivative suits. One reason was that allowing double-derivative suits would have a deterrent effect with respect to misconduct or, generally, any breach of fiduciary duty by a director of a subsidiary. Another reason was that damages or losses by a subsidiary ultimately have a negative impact on the parent company. Finally, the court held that the 'shareholders' permitted by the Commercial Code to file derivative actions may be interpreted to include shareholders of shareholders that are corporations.

b. Other rulings

*i. Initial public offering of Sungdam shares.*

In his derivative suit against the directors of Hwasungsa, the plaintiff claimed that the decision of the Sungdam board to make a public offering of Sungdam shares was unnecessary and detrimental to the firm. This claim appears to have been incorrectly filed, as it is clear that the decision to make a public offering was made by Sungdam and not Hwasungsa. The court dismissed the claim, because the plaintiff did not have proper standing.

*ii. Sale of Sungdam shares by Hwasungsa to third parties.*

The plaintiff filed a derivative suit against the defendants as directors of Hwasungsa, alleging that the company sold stocks to certain third parties below market price, thereby causing harm to Hwasungsa. The court rejected the plaintiff's argument that the shares were undervalued, as the sales prices were close to the market price. As a dictum, the court ruled that the sale of shares of a subsidiary would not be subject to special approval at a shareholders' meeting unless the shares to be sold are substantial and the selling entity is merely a holding company.

*iii. Sale of Sungdam shares to pay inter-company debt.*

The court also rejected the plaintiff's argument that Hwasungsa should have paid the inter-company debt to Sungdam by issuing new shares, merging with Sungdam, or receiving dividends from Sungdam. In addition to the practical difficulties of a capital increase and merger and dividend distribution due to a dispute between the two largest shareholders of Hwasungsa, the court accepted the decision of Hwasungsa's board.

3. Comment

Although *Eun Sub Jung* represents the first double-derivative action to appear before Korean courts, the court's opinion regarding the standing of the plaintiff appears to be based on general principles and arguments in connection with the issue of double-derivative actions, and does not set any clear thresholds or delineate any clear boundaries for future double-derivative cases. For example, although the court states in its decision that one of the factors in finding that the plaintiff had proper standing for the double-derivative suit was that Hwasungsa controlled Sungdam, it failed to explain what level of ownership is deemed to merit 'control.' However, it is possible to infer some general guidelines that the courts may follow to find standing in future double-derivative cases. For example, it is likely that courts reviewing future double-derivative actions will require a substantial connection between the parent company and subsidiary in the manner that existed between Hwasungsa and Sungdam (e.g., a large shareholding interest and common directors). It should be noted, however, that *Eun Sub Jung* is not yet final and is being appealed to the Supreme Court.

In addition, the theories applied by the court in *Eun Sub Jung* can be extended to apply to derivative suits brought under other derivative action clauses provided under the Commercial Code such as article 324 (concerning promoters' liability and shareholders' derivative suits), article 424-2 (concerning the liability of subscribers of shares at unfair prices) and article 467-2 (concerning prohibitions against granting pecuniary benefit) as well as under the Securities and Exchange Act.

## II. Competition Law

### A. New Reporting Requirements for Business Combinations

On May 2, 2003, the Korea Fair Trade Commission changed its business combination reporting regulations by issuing Notification 2001-11, which requires foreign companies to report certain significant business combinations occurring between foreign companies outside Korea. With the issuance of Notification 2000-11, Korea joins other jurisdictions, including the United States and the European Union, that require certain significant business combinations between foreign countries occurring outside their territories to be reported. The new requirement will apply on July 1, 2003 only with respect to mergers.

#### 1. *Which Business Combinations Should Be Reported?*

Under Notification 2000-11, if any party to a business combination has a total amount of assets or turnover (including those of affiliates) of at least W100 billion (approximately USD $83 million) and engages in one of the following business combinations, it must report the business combination to the commission:

- A corporation, including its affiliates, acquires 20 percent or more (15 percent or more for corporations listed on the Korea Stock Exchange or registered with the Korea Securities Dealers Automated Quotation (KOSDAQ)) of the total outstanding shares (excluding non-voting shares) of another corporation;
- A director or auditor of a corporation concurrently holds the position of director or auditor of another corporation (a so-called 'interlocking' directorate);
- One corporation merges with another;
- A corporation takes over or leases the whole or a substantial part of the business of another corporation, undertakes the management of another corporation, or takes over the whole or part of the fixed operating assets of another corporation; or
- A corporation subscribes to 20 percent or more of the shares of a corporation to be established.

In addition to the above requirements, Notification 2000-11 also requires that a business combination between foreign corporations shall be reported to the commission if the total assets or worldwide turnover of at least one party is at least W100 billion and the domestic turnovers of the respective parties to the business combination are at least W3 billion (approximately U.S.$2.5 million). Generally, 'domestic turnover' is deemed to include the party's affiliates sales turnover in Korea. In this context, if no other criteria to define the affiliate are available, the "affiliates" are the companies that are included in the consolidated financial statements of the reporting company.

2. *When Should the Business Combination Be Reported?*

If at least one of the parties to the business combination is a large-scale enterprise (i.e., with assets or turnover, including those of its affiliates, exceeding W2 trillion (approximately U.S.$1.7 billion), business combinations that take the following form must be reported before they are effected:

- One corporation merges with another;
- A corporation takes over or leases the whole or a substantial part of the business of another corporation, undertakes the management of another corporation, or takes over the whole or part of the fixed operating assets of another corporation; or
- A corporation subscribes to 20 percent or more of the shares of a corporation to be established.

A business combination that would be subject to this pre-merger reporting requirement should not be affected until the expiration of the waiting period, which is thirty days from the filing of the business combination report with the commission. The waiting period may be extended for up to another thirty days. Business combinations that are not subject to the pre-merger reporting requirement may be reported up to thirty days after the business combination occurs.

3. *Penalties*

Failure to comply with the reporting requirement could incur a fine range from W1 million (approximately U.S.$830) to W100 million (approximately U.S.$83,000).

B. Public Notice of Draft Amendment of the Anti-Monopoly and Fair Trade Act

Proposed amendments to the Anti-Monopoly & Fair Trade Act (AFTA) seek to enhance transparency in corporate management and ensure free and fair market competition by improving regulations concerning holding companies, business combination investigations, and compensation for damages in private actions. The amendments will most likely be passed by the National Assembly shortly after the general election in April 2004.

1. *Regulations on Holding Companies*

As a way to reduce the complicated cross, indirect, or circular holdings among conglomerates, the Korea Fair Trade Commission (KFTC) has encouraged the establishment of holding companies under certain conditions. A holding company must have total assets of KRW 100 billion, and one-half or more of its total assets must be made up of the shares of its subsidiaries. A holding company is prohibited from being indebted in excess of its net assets. It must hold at least a 50 percent equity interest in its subsidiaries (30 percent in the case of subsidiaries that are listed companies). It cannot acquire the shares of other companies for the purposes of gaining or exercising control after it becomes a holding company. Financial holding companies may only acquire the shares of banks, insurance companies, and other financial services companies. Conversely, the shares of financial services companies cannot be acquired by non-financial holding companies.

As a transitional measure, however, there are certain grace periods for the above requirements and prohibitions. The proposed amendments would extend such grace periods, or make the requirements less rigorous, so that holding companies can be established with less difficulty. The grace period for meeting the above debt-related requirement after a company qualifies to be a holding company would be extended to two years (from the current one year grace period). In addition, grace periods would apply to all companies that would be converted into holding companies, regardless of the means of conversion.

The amended AFTA would also lower from 50 percent to 30 percent the share percentage that a company is required to hold in order to qualify as a holding company of an unlisted company. Further, a holding company's subsidiary would be prohibited from making a capital contribution to another subsidiary of that holding company.

2. *Regulations on Review of Business Combinations*

Under the current AFTA, if a company has aggregate assets or turnover (including the assets or turnovers of all of its affiliated companies and related persons worldwide) of KRW 100 billion or more, then it must file a "business combination report" with the KFTC with respect to the following transactions: (1) the direct or indirect acquisition of 20 percent (15 percent in the case of listed companies) or more of the outstanding shares of an unlisted company; (2) the creation of interlocking directorates and the cross-posting of certain types of officers; (3) merger with another company; (4) the acquisition of the whole or a substantial portion of the business of another company; or (5) the subscription of at least 20 percent of the issued shares of a newly-established company (subject to certain exceptions). Further, if an acquired company reaches this KRW 100 billion threshold, a business combination report from the acquiring company is required. When KFTC receives a report, it will investigate the transaction to determine whether such acquisition is anti-competitive. Upon its findings, it will issue an antitrust clearance, a conditional approval, rejection order, or divestiture order.

Generally, a company should file the report within thirty days after the transaction's date of completion. If, however, the reporting company has aggregate assets or turnover (including the assets or turnovers of all affiliated companies and related persons worldwide) of KRW 2 trillion or more, then the report should be filed prior to completion if the transaction falls into categories 3, 4, or 5 above. These types of transactions will be subject to a thirty-day standstill period, which may be abbreviated or extended by KFTC to a maximum of sixty days.

The following amendments to these reporting requirements have been proposed:

- Requiring *ex-ante* reporting to KFTC (instead of *ex-post* reporting) of business combinations involving stock acquisitions by large companies;
- Increasing the maximum extension period for review of the business combination report from sixty days to ninety days;
- Imposing an obligation to file an amended business combination report if, because of an additional acquisition of shares, an investor becomes the largest shareholder after the filing of the initial report;
- Providing a basis for exemption from reporting obligations if the acquired company is a small company; and
- Not requiring interlocking or cross-posted officers and directorates to be reported in the business combination report if the directors are from affiliated companies.

3. *Private Right of Action*

The AFTA set forth various administrative and criminal sanctions for certain types of violations. In addition, the AFTA provides a private right of action in certain situations with respect to damages stemming from violations of the AFTA. If a person has been aggrieved by another's violation of the AFTA, then in certain circumstances the aggrieved person may commence a private claim for damages in the appropriate court of first instance.

With respect to compensation for damages resulting from a violation of the AFTA, the proposed amendments would:

- Delete a provision that provides that a private claim for damages with respect to a violation of the AFTA cannot be filed until after the corrective measures under the AFTA are finalized (this provision was interpreted as limiting a person from bringing a claim before the court unless and until corrective measures have been finalized);
- Exempt a defendant from liability for a violation of the AFTA if the defendant can prove that the violation was not willful or negligent (currently, a defendant will be held liable irrespective of an absence of willfulness or negligence);
- Allow the court to determine the amount of damages after taking into account relevant evidence and the arguments of the plaintiffs and defendants if, due to the nature of the damages, it is very difficult for the plaintiff to prove the exact amount of damages; and
- Revise the statute of limitations to "3 years from the date of knowledge or 5 years from the date the violation ended."

## III. Labor Law

### A. Revision to the Labor Standard Act

1. *Background*

In order to enhance the quality of life for workers and strengthen a company's competitiveness, the revised Labor Standard Act shortens statutory work hours and attempts to make the work hours and vacation time conform to international standards. Depending on the size of the employer, the new standards will take effect on different dates between July 2004 and the year 2011. An employer may elect to apply the laws prior to the effective date, however, only by obtaining the consent of the labor union or a majority of the workers and then filing a report with the Ministry of Labor.

2. *Noteworthy Features*

- *Work Hours:* Statutory work hours have been shortened from forty-four hours per week to forty hours per week. The revised Labor Standard Act also provides greater flexibility in its "flexible work hour system." The flexible work hour system specifies that within a basis period, working hours on a certain day or certain week may exceed the statutory limit for work hours, as long as the average work hours within the stated basis period is not exceeded. The basis period used in the calculation has been extended from one month to three months.
- *Optional Paid Leave:* An employer, by written agreement with the representative of the employees, may elect to grant paid leave instead of overtime pay. This provides employers and employees a broader range of options with respect to wages and vacation time.
- *Vacation:* Consistent with international standards, monthly paid leave will be abolished and monthly menstrual leave—whereby female employees were allowed to take one

day of paid leave per month—will become unpaid leave, thus alleviating the employer's financial burden.

Prior to the revision, employees with a perfect attendance record for their first year of employment were given ten days of annual vacation time. If they were in attendance for eight-tenths of their first year of employment, they were given eight days of annual leave. After the first year, employees' vacation time increased by one day following their perfect attendance each year. Annual vacation could increase up to twenty days in which event the employer had an option to pay money to the employee in lieu of additional vacation days. In addition, monthly leave, which accrues one day for each month of perfect attendance, is granted under the existing law but would be abolished under the revised law. Under the revised law, employees will be given fifteen days of annual vacation if they maintain an 80 percent attendance rate for the first year of employment. Thereafter, their vacation leave will increase by one day for every two years of perfect attendance until their annual vacation leave reaches twenty-five days. At that point, the employer has the option of paying the employee for additional vacation days. Persons who have been employed for less than one continuous year are entitled to receive one day of leave for each month of perfect attendance. Any leave so taken shall be deducted from the annual leave that the person is otherwise entitled to.

- *Promoting the Use of Vacation Time:* The revised Labor Standard Act seeks to promote employee use of entitled vacation time. If an employee does not use his vacation time in spite of the employer's efforts to promote the employee's use of annual leave, the employer is exempted from the obligation to compensate the employee for those portions of annual vacation time that the employee did not take. The efforts that the employer must make are as follows: (1) the employer must notify, in writing, each employee of the number of unused annual leave days within a ten day period starting three months prior to the end of the year in which the employee is entitled to take the annual leave. The employer should also urge the employee to decide when he will take his annual leave and notify the employer of that decision; and (2) if the employee does not notify the employer of his decision about when he will use his leave within a ten day period from the receipt of the employer's notice, the employer must decide by two months prior to the end of the year in which the employee is entitled to take such annual leave, the time in which the concerned employee is to take his/her annual leave.
- *Interim Measures:* For a limited three-year period from the date the revised law comes into effect for each respective employer, the parties may agree that work hours can be extended by a maximum of up to sixteen hours per week instead of twelve hours, as currently set forth in the Labor Standard Act. Also, in case the parties agree to an extended work hour, the employer has to pay an extra 25 percent wage premium for the first four hours of extended work hours and an extra 50 percent wage premium for the remaining extended work hours.
- *Maintaining the Same Wage Level:* The employer must ensure that as a result of following the revised law, his employee's income levels do not get lowered.